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SUBJECT: UKRAINE: GAZPROM AGAIN THREATENS UKRAINE OVER DEBT,
INTERMEDIARIES

REF: A) KYIV 451
B) KYIV 162

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11. (U) Summary. Gazprom has indicated it had grown tired of Ukraine's inability to sign and implement the February 12 gas agreement announced by Putin and Yushchenko and threatened to reduce gas supplies to Ukraine by 25 percent beginning on March 3, moving up a previously announced deadline of March 14. As has become familiar in gas disputes between the two countries, Gazprom says the debt is not fully settled, whereas Ukrainian politicians and NaftoHaz disagree. The Gazprom threat came on the heels of statements by Prime Minister Yuliya Tymoshenko's government that Ukraine doesn't need the type of new joint venture that is supposed to replace gas intermediary UkrHazEnerho (UHE) in accordance with the agreement announced by Yushchenko and Putin. Tymoshenko's government made the announcement shortly after her February 20-21 meetings with Putin and Gazprom in Moscow, where she apparently failed to get Russian support for her vision of the Ukrainian gas market. Tymoshenko's actions place her in direct contradiction to Yushchenko and his agreement with Putin. Many commentators are arguing that Gazprom is not in reality pressuring Ukraine on the debt issue, but rather because of Tymoshenko's open resistance to a new domestic intermediary that would give Gazprom direct and increased presence in the Ukrainian market. As the gas dispute with Russia evolves, the lack of a coordinated approach between Yushchenko and Tymoshenko will weaken the Ukrainian position and dim its hope to secure better conditions for both the delivery of gas and the structure of intermediaries. End summary.

Gazprom Again Threatens Ukraine with Supply Reductions

12. (SBU) On February 26, Gazprom spokesman Sergei Kupriyanov announced that Ukraine must meet the conditions of the February 12 Putin-Yushchenko agreement (ref A), or 25 percent of gas supplies to Ukraine would be slashed on March 3. This brought forward the March 14 debt repayment deadline issued by Gazprom last week. Embassy contacts at NaftoHaz and other local observers professed to be unworried about an actual reduction, arguing the dispute would likely be resolved soon. Technical experts told us a 25 percent reduction in supplies to Ukraine was unlikely to pose major danger to the stability or performance of the gas supply network. During their February 12 meeting in Moscow, Yushchenko and Putin reached a last-minute agreement that avoided Gazprom's then threatened cut off of gas supplies to Ukraine. They agreed on the repayment of Ukraine's debt and on the replacement of intermediaries RosUkrEnergo (RUE) and UkrHazEnerho (UHE) with two new joint ventures, each equally owned by Gazprom and NaftoHaz. The debt repayment plan did

not articulate the scope and schedule of repayment, and talks between Gazprom and NaftoHaz have stalled over disagreements on the exact terms of the new deal. Contributing to the impasse is an apparent difference in approaches between Yushchenko and Tymoshenko towards resolving the most recent gas crisis.

Total of Gas Debt Still in Dispute

¶3. (U) Gazprom has repeatedly claimed that Ukraine owes \$1.5 billion through January. Ukraine has acknowledged a debt of \$1.072 billion dollars for 2007 gas deliveries, with agreement on the amount and schedule of payment for January deliveries to be made by the end of February. Naftohaz has begun paying the debt to UkrHazEnergo (UHE) as Yushchenko accused the Tymoshenko-led government of sabotaging the agreement with its delay in making payments. First Deputy Prime Minister Oleksandr Turchynov, however, blamed the delay in repayment on RosUkrEnergo (RUE) and UkrHazEnerho (UHE), the existing intermediaries, for not having presented documents that clearly articulate the calculations for the gas debts.

Yushchenko Claims 2007 Debt Repaid in Full

¶4. (U) On February 27, President Yushchenko claimed that the debt for 2007 had been paid in full. He said about UAH 3.8 billion of the UAH 5 billion debt (around \$1 billion) Naftohaz owed to UkrHazEnerho had been paid back in cash. The remaining UAH 1.2 billion (about \$240 million) would be offset by dividends that UkrHazEnerho owes to NaftoHaz but has never paid. UHE immediately countered that using anticipated dividends to pay off the debt was illegal and stated that NaftoHaz still owed UHE \$270 million for 2007 supplies. Gazprom, while acknowledging progress, pointed out

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that the debt for 2008 remained and was continuing to grow. Gazprom and NaftoHaz representatives will meet in Moscow on February 29 to continue talks; however, it remains unclear whether the payment by NaftoHaz was sufficient to defer the March 3 deadline, or whether the deadline stands. Gazprom's CEO Alexei Miller said in a press interview that Gazprom sees the debt repayment as a start to the resolution of the problem.

Gas Market Restructuring Also Contentious

¶5. (SBU) A strident proponent of the removal of intermediaries in the Ukraine-Russia gas trade, Tymoshenko had already advocated dismantling the existing gas supply system prior to the Putin-Yushchenko summit. Rhetoric from her camp suggested a vision that, in particular, did not see the necessity of a Joint Venture (JV) with Gazprom to replace UHE. It came as no surprise then that, prior to Tymoshenko's February 20th meetings with Russian Prime Minister Viktor Zubkov and Putin in Moscow, there was speculation that Tymoshenko hoped to alter the course of the gas debate that had been initiated by the two presidents a week earlier. Her deputy Turchynov went so far as to say that, because Moscow had proposed unacceptable terms and conditions, Tymoshenko would have to start negotiations "from scratch." Not only did the idea of a fresh start receive pushback from the Russians, who succeeded in keeping it off the agenda, but also from President Yushchenko as well, who insisted that PM Tymoshenko act in concert with the agreement with Putin.

Gazprom's Proposed Agreement Revealed

¶6. (U) The newspaper Kommersant revealed the contents of a draft agreement purportedly prepared by Gazprom, the terms of which appeared to be very unfavorable to Ukraine. According to the draft, the new RUE Joint Venture (tentatively named RosUkrHaz) would no longer have the right to re-export Central Asian gas to the Eastern European market, a key element of its profitability. A recent press report indicates that Gazprom has given the existing RUE permission to re-export 3-8 bcm of Central Asian gas annually to Europe for at least two more years, a proposition that could entail annual profits

ranging from \$500 million to \$1.3 billion. An energy expert suggested to us that this is likely a concession made to avoid a legal tangle over broken contracts, and looked very similar to the old structure. According to a Gazprom source quoted in the Russian press, in other respects the new JV would change very little; it would continue to be based in Switzerland with familiar faces in management, including Gazprom board member Konstantin Chuychenko.

Russia and Ukraine Disagree on UHE Replacement

¶7. (U) The terms for the UHE replacement proposed in Gazprom's reported draft agreement also appear to be disadvantageous to Ukraine. In addition to the agreed upon doubling of Gazprom's ownership stake to 50 percent, the proposal reportedly would expand the new JV's customer base to include all segments of the domestic market, stipulate signing long-term contracts with Ukraine's ultimate consumers until 2028, require prepayment when buying gas, and extend the joint venture's control beyond UHE's current ambit to include the sales of all gas on the domestic market, including Ukrainian gas produced by NaftoHaz.

¶8. (U) The proposed expansion of the new JV's role stands in direct contrast to both rhetoric and actions from Tymoshenko's camp aimed at developing a more substantial role for NaftoHaz (ref B). On February 6 Tymoshenko's Cabinet annulled the January 2006 resolution on the creation of UHE and instructed NaftoHaz to liquidate the intermediary. It also named NaftoHaz as the sole supplier of gas to the industrial sector. Following her return from Moscow last week, Tymoshenko indicated that UHE would be eliminated from the market in the first quarter of 2008. She also commissioned the Cabinet members to prevent government-connected entities from signing contracts with UHE and not to allow customs clearance for gas supplied by UHE to Ukraine. The Prime Minister indicated that there will be "another contractual model." It seems likely that Tymoshenko's contractual model, which she considers consistent with the Presidents' framework agreement, will be difficult to reconcile with the Joint Venture proposed by Gazprom.

¶9. (SBU) Comment: The Putin-Yushchenko agreement increasingly appears to bring only a slight change to the existing gas arrangements, likely more beneficial in the long run for Russia than Ukraine. Tymoshenko, who had intended to drastically change the gas supply mechanism, appears to be losing this struggle with the

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Yushchenko camp. However, until Yushchenko and Tymoshenko are able to reconcile their positions, Russia will maintain an advantage in negotiations in which unwelcome positions are countered with renewed threats of a gas cutoff. End comment.
TAYLOR